

**REPORT TO THE TWENTY-THIRD LEGISLATURE
STATE OF HAWAII
2006**

DRINKING WATER TREATMENT REVOLVING LOAN FUND

**PURSUANT TO SECTION 340E-33,
HAWAII REVISED STATUTES
RELATING TO THE
DRINKING WATER TREATMENT REVOLVING LOAN FUND
OF THE DEPARTMENT OF HEALTH**

**PREPARED BY:
STATE OF HAWAII
DEPARTMENT OF HEALTH
ENVIRONMENTAL HEALTH ADMINISTRATION
ENVIRONMENTAL MANAGEMENT DIVISION
SAFE DRINKING WATER BRANCH
WASTEWATER BRANCH
DECEMBER 2005**

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OPERATIONS & ADMINISTRATION SECTION

A. INTRODUCTION

The State of Hawaii, Drinking Water Treatment Revolving Loan Fund (DWTRLF) program was established by the 1997 State Legislature as the result of the 1996 Federal amendments to the Safe Drinking Water Act. The DWTRLF program is administered by the Safe Drinking Water Branch and Wastewater Branch of the Department of Health.

This program currently provides low interest loans to public water systems for the construction of drinking water infrastructure projects to help maintain compliance with drinking water standards and protects the public health and environment of Hawaii. The primary clients of the DWTRLF program (a.k.a. Drinking Water State Revolving Fund [DWSRF] under Chapter 11-65, Hawaii Administrative Rules) are the County water departments for Kauai, Maui and Hawaii and the City and County of Honolulu.

By helping local government entities improve and expand their drinking water infrastructure, the DWTRLF helps to protect the public's health and the environment of Hawaii. Equally important, the DWTRLF Program plays a vital role in the economic development and vitality of Hawaii's communities.

B. EXECUTIVE SUMMARY

The Hawaii DWTRLF program has received \$50.7 million in federal funding and the additional required twenty percent (20%) State match contributions of \$13.4 million for a total of \$64.1 million to support the DWTRLF loan program and drinking water administration.

During SFY 2005, the Hawaii DWTRLF program issued final loan agreements totaling \$4.3 million to the Counties of Kauai and the City and County of Honolulu and interim loan agreements totaling \$15.4 million to Counties of Maui and Kauai and the City and County of Honolulu. These interim loan agreements mentioned are anticipated to be converted to final loan agreements in SFY 2006.

The DWTRLF program continues to meet its objectives of: a) providing low interest loans to Hawaii's four Counties for the construction of drinking water infrastructure projects; b) operating the program in perpetuity in such a manner to attain and maintain self-sufficiency; and c) complying with all EPA State Revolving Fund (SRF) program requirements including federal cross cutters, MBE/WBE requirements and standard accounting practices. This conclusion is supported by the latest SFY 2004 annual independent audit of the program by the accounting firm of Grant Thornton LLP.

In conclusion, the DWTRLF program is looking forward to an exciting SFY 2006 as the program further progresses to the next stage of providing loans to the county public water systems.

C. MAJOR INITIATIVES

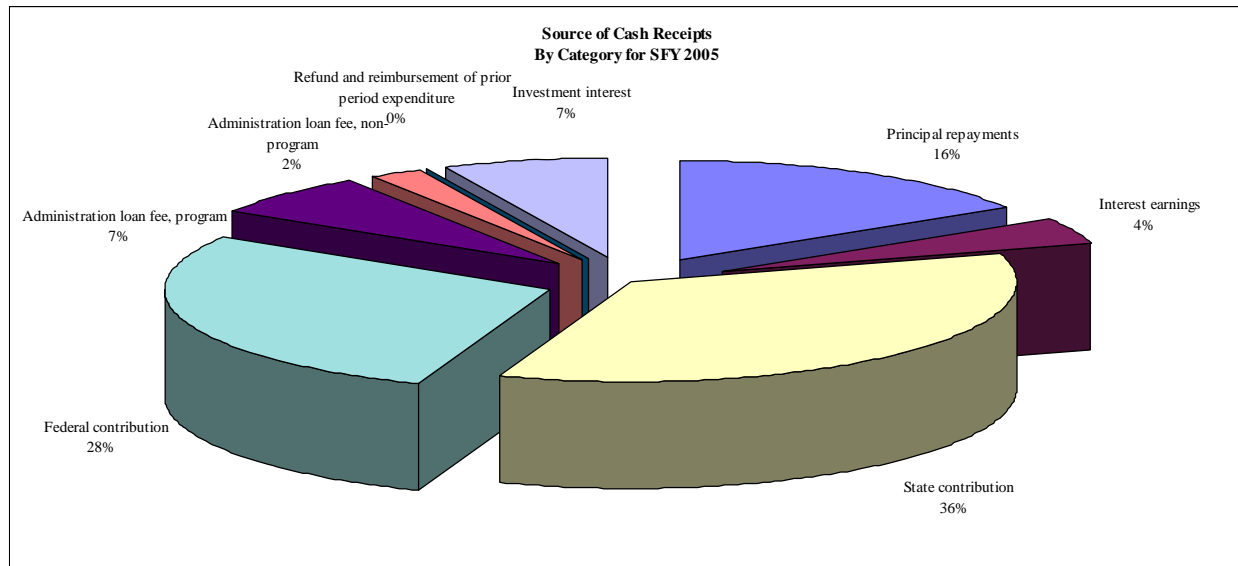
1. Pursuant to the Act 200/03, as amended by Act 41/04, the 2004 Hawaii State Legislature provided local match funds to the federal capitalization grant in the amount of \$1,611,000.

An overview of the DWTRLF for SFY 2005 includes the following:

a. Funds withdrawn from the federal Automated Standard Application for Payments (ASAP) system:	\$ 1,283,843.40
b. State match funds for FFY 2004 Federal Capitalization Grant provided:	\$ 1,611,000.00
c. State match funds distributed:	\$ 134,463.09
d. Loans executed:	
Three Final Loan Agreements:	\$ 4,304,115.00
Four Interim Loan Agreements:	<u>15,429,595.00</u>
Total Loans Executed:	\$19,733,710.00
e. Principal repayment received:	\$ 730,131.31
f. Interest repayments received:	\$ 181,382.23

Graph 1 below shows the percentage breakdown of sources of cash by category received for the SFY 2005.

Graph 1.



2. The award of low-interest DWTRLF loans involves a two-step process. First, an Interim Loan Agreement is prepared and signed based on initial cost estimates, which commits the funds to the water boards. Second, after project contracts are awarded, a Final Loan Agreement is prepared and executed, after which funds can be disbursed.

If there are any changes to the Final Loan Agreement (e.g. an increase or decrease in loan amount, a change in interest rate, etc.), a Supplemental Loan Agreement is prepared and signed. The effective date of the agreement is determined by when the agreement is ready to be routed and signed by all parties.

a. The following Interim Loan Agreements were processed and executed in SFY 2005:

<u>County Board</u>	<u>Project Description</u>	<u>Project Location</u>	<u>Loan Amount</u>
Kauai	Poipu Road 16 inch Main Replacement (Executed 1/15/05)	Senate District 7 House District 16	\$ 1,742,754.00
Kauai	16 inch Waterline Replacement along Kuhio Highway (Executed 1/15/05)	Senate District 7 House District 14	\$ 2,434,438.00
Maui	Kamole Weir Water Treatment Facility Clear Well Replacement (Executed 1/15/05)	Senate District 6 House District 12	\$ 6,963,440.00
Honolulu	California Avenue Water System Improvements, Parts II and III (Executed 4/15/05)	Senate District 22 House District 39	\$ 4,288,963.00
TOTAL INTERIM LOAN AGREEMENTS			\$15,429,595.00

b. The following Final Loan Agreements were processed and executed in SFY 2005:

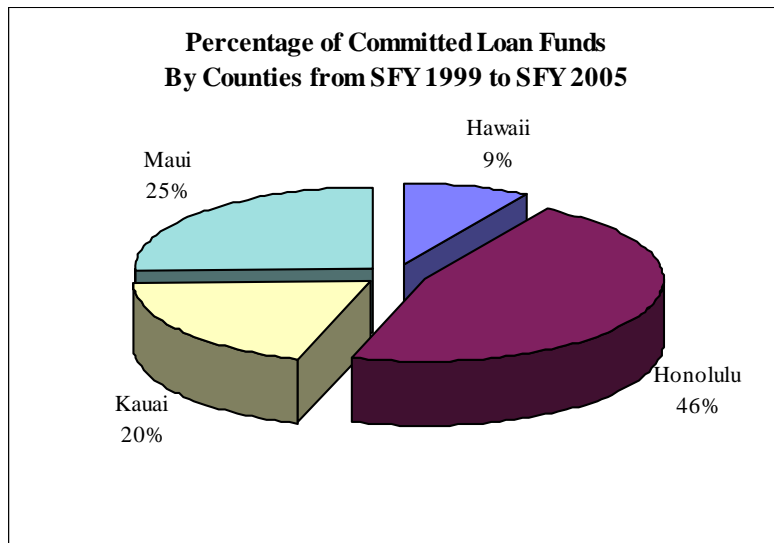
<u>County Board</u>	<u>Project Description</u>	<u>Project Location</u>	<u>Loan Amount</u>
Honolulu	Waimanalo Well III (Executed 12/15/04)	Senate District 25 House District 51	\$ 2,251,700.00
Kauai	Rehabilitate Lihue Steel Tanks 1 & 2 (Executed 1/15/05)	Senate District 7 House District 15	\$ 1,243,017.00
Kauai	Ornellas 0.2 MG Tank Refurbish (Executed 1/15/05)	Senate District 7 House District 14	\$ 809,398.00
TOTAL FINAL LOAN AGREEMENTS			\$ 4,304,115.00

- c. The following DWRTL projects were awarded Interim Loan Agreements in previous fiscal years and continues to be processed for Final Loan Agreements during SFY 2005:

<u>County Board</u>	<u>Project Description</u>	<u>Project Location</u>	<u>Loan Amount</u>
Hawaii	Honomu Well "A" (Replace Akaka Falls Spring) (Interim executed 12/15/03)	Senate District 1 House District 1	\$ 1,168,109.00
Honolulu	Kunia Wells II-Nitrate Treatment Facility (Interim executed 3/15/04)	Senate District 19 House District 41	\$ 6,029,374.00
Honolulu	Ewa Shaft Granular Activated Carbon (GAC) Treatment Facility (Interim executed 3/15/04)	Senate District 18 House District 35	\$14,460,755.00
TOTAL FINAL LOAN AGREEMENTS IN PROGRESS			\$21,658,238.00

The percentage of committed loan funds by Counties is illustrated in Graph 2 below.

Graph 2.



D. GOALS AND ACCOMPLISHMENTS

Section 1452(b) of the Safe Drinking Water Act requires the State to prepare a plan, called an Intended Use Plan (IUP), identifying the intended uses of funds in the DWTRLF and to describe how those uses support the goals of the DWTRLF program.

The IUP is prepared annually and made available for public comment and review. The program published its IUP for SFY 2005 on May 12, 2004. The IUP is also a requirement in the State's SRF Capitalization Grant Application process to EPA.

The following is a summary of the goals and accomplishments for the SFY 2005 and a summary of the program achievements throughout the year.

Long-Term Goals:

1. To assist as many water purveyors as possible to attain compliance with State and Federal Drinking Water Regulations through the low interest program.

The DWSRF program continues to work with all four major counties in Hawaii to provide SRF loan funds. The four counties own and manage a majority of the public water systems statewide with small, medium, and large sized systems and the low interest loan funds provide an affordable means of financing numerous projects in different systems. The various projects in the different systems are thus able to provide assistance to many people throughout the State of Hawaii.

2. To maintain the DWSRF Program in perpetuity.

The DWSRF program continues a conservative approach to expenditures in SFY 2005 ensuring the perpetuity of the program. To supplement the four percent set-aside and administrative demands, the program assesses fees to each loan to ensure that the administrative needs are financed in perpetuity.

3. To research options of providing funds to assist in financing improvements to privately owned public water systems.

In previous years the DWSRF program successfully revised the Hawaii Revised Statutes (HRS) to authorize a linked deposit program. After the fact, it was found that HRS, Section 38-3, however, imposes additional requirements on participating financial institutions to maintain a 100% reserve equal to the amount to be loaned. The reserve fund requirement and other possible regulatory requirements will ultimately limit participation by financial institutions and the program needs to conduct further research to ensure that the program developed has benefits to all parties involved. Thus, further research needs to be completed to entertain innovative alternate means to provide funding to privately owned public water systems. Additionally in SFY 2005, the DWSRF program has been concentrating its efforts in working with the counties to move

projects forward to construction and execution of the final loan agreements.

Short-Term Goals:

1. Continue development of a system to track the currently required tracking items which may include accounting, management, set-asides, compliance and customer service concerns.

The DWSRF staff continues to work with Northbridge Environmental Management Consultant in developing an Access Database program capable of tracking information and providing reports for the DWSRF program (referred to as the Northbridge database). A main obstacle in the database development is the broad scope of information which is being combined into one tracking program; project and financial information, set-aside expenses and related reports. Some of the project and financial information includes engineering review and construction inspection information, financial loan information, payments and repayment information. Additionally, the program spends set-aside funds outside of the project loans, and those monies need to be accounted for with expenses being reported back to EPA. There are different staff members in different branches who will be responsible for inputting data into the system, and therefore, system development has become complex.

Development and testing continues, with new testing needed each time an updated version is sent to the state staff. The program expects to continue to work on the program until a viable product is achieved, and the final product will be used to develop annual report statements and the annual Drinking Water National Information System (DWNIMS) information.

2. Continue modification of the Functional Procedures to reflect and meet the DWSRF requirements and needs.

Review revisions and updates of the Functional Procedures to reflect and meet the DWSRF program requirements and needs continue throughout each year. The program continues to improve forms and samples used for applicants and consultants as needed.

3. Continue to integrate the Capacity Evaluation program with the DWSRF loan program.

The DWSRF program continues to monitor, discuss and review the technical, managerial and financial status and condition of the four Hawaii Counties, the current customer base. Additionally, the Safe Drinking Water Branch, through the Capacity Evaluation program, continues to work with various private and small water systems to evaluate their technical, managerial and financial status and condition. A revised questionnaire regarding capacity issues has been recently added to the Sanitary Survey evaluation to ensure that each survey includes capacity evaluation components. The DWSRF program will use the revised evaluation form to reevaluate the current DWSRF borrowers.

E. COMPLIANCE MATTERS

The Hawaii DWSRF program has complied with the applicable requirements outlined in the Operating Agreement, Chapter II, Implementation, Section D, State Assurances for the DWSRF Program, and Section E, State Requirements for the Capitalization Grant Agreement. The requirements included the following:

1. Environmental Review - Each DWSRF project has undergone an environmental assessment and review. Environmental assessment documents were prepared by the County Water Departments in accordance with HRS Chapter 343 (Environmental Impact Statements) and Hawaii Administrative Rules, Chapter 11-200, and were submitted to the Office of Environmental Quality Control (OEQC) of the State of Hawaii for review and publication. For exempt projects, DWSRF Exempt Project Certification forms were submitted to the DWSRF program with the qualifying exemption identified.
2. Intended Use Plan - The Draft Intended Use Plan for SFY 2005 was completed in March 2004, and a notice for public participation and input was published on April 1, 2004 with an open comment period until April 30, 2004. There were no comments submitted within the public comment period. The Drinking Water Treatment Revolving Loan Fund Intended Use Plan for the State of Hawaii SFY 2005 / FFY 2004 Appropriation was finalized and dated May 12, 2004.
3. Other Federal (“Cross-cutter”) Requirements - The County Water Departments certify for each of their DWSRF projects that they are in compliance with all the federal cross-cutter rules and regulations. Each project must include the Federal Boiler Plates in the project specifications used for bidding.

PACE CONCERNS:

The Hawaii DWSRF program has been working closely with EPA and the four Counties to improve on the pace of the program and to execute loan agreements. In a November 14, 2003 EPA correspondence, EPA implemented the DWSRF Binding Commitment Action Plan (BCAP) to assist Hawaii’s DWSRF with meeting the binding commitment requirements. Follow up letters on February 27, 2004 and April 8, 2004 provided updates on the progress of the program to execute binding commitments. Hawaii’s DWSRF subsequently issued numerous interim loan agreements and has continued to meet the binding commitment requirements in SFY 2005.

As the Hawaii DWSRF program achieved compliance with the binding commitment requirements, a May 10, 2004 letter from DOH to EPA requested to change the name of the action plan to the “Fund Utilization and Efficiency Plan” (FUEP). The proposed FUEP continued to track binding commitments and included a schedule for executing Final Loan Agreements. The May 28, 2004 EPA Program Evaluation Report (PER) of Hawaii’s SRF accomplishments through March 2004, concurred with DOH to change the action plan name to the FUEP.

On September 9, 2004, a letter to DOH from EPA regarding a follow up of the PER and approval of the FFY 2005 DWSRF Workplan, further identified other outstanding items in addition to meeting the binding commitment and loan pace requirements, that the Hawaii DWSRF program needed to achieve in the next year. Numerous items identified in the PER review are addressed below, while others have been incorporated into this annual report. The DWSRF FFY 2005 Workplan laid out the plan of action for completing loan agreements and provided a basis for EPA to evaluate the progress of the program.

Outstanding issues that DOH continues to address are:

DWSRF Interest Rate/Administration Fee: The DWSRF program continues to review revisions to the Hawaii Administrative Rules which would possibly allow for greater flexibility in adjusting the interest and fee amounts charged.

DWSRF Set-Asides: The 15% Set-Aside has a requirement where if funds are not allocated in a workplan within one-year of the grant award, those funds must be returned to the DWSRF loan fund. The DWSRF program has researched and has identified funds from 1997 to present from the 15% Set-Aside which must be returned to the DWSRF loan fund. The return of those funds will be made in SFY 2006. An improved tracking system has been developed and implemented to ensure that funds not allocated in a workplan will be identified annually and returned in a timely manner.

DW Data System: The DWSRF along with the Hawaii CWSRF program continue to work on the development of the Northbridge database system.

AUDIT CONCERNS:

The EPA - Office of Inspector General (OIG) identified three concerns regarding the Single Audit Report for the State of Hawaii - Department of Health (DOH), Audit Report Number 2005-3-00076, Audit Period: July 1, 2002 to June 30, 2003 via a January 27, 2005 letter.

The first item concerned non-compliance with the Binding Commitment requirement. By March 15, 2004, the program had returned to compliance with this requirement and has continued to be in compliance.

The second item noted that the DOH did not record \$132,768 in its equipment records and recommended that the Safe Drinking Water Branch (SDWB) management ensure that its fixed asset control policies and procedures be followed and operated efficiently. The equipment was recorded in December 2003 and noted that the SDWB would work with the State Laboratory Division to ensure that future purchase orders and contract purchase documents are properly submitted and tracked.

The third item noted that the State did not maintain adequate documentation to ensure it provided state match monies equal to 100% of the State Program Management set-aside costs. A June 22, 2005 letter from DOH to EPA noted that the match requirement had

previously been tracked through the Financial Status Reports (FSR's) up until 2002. However, from the 2003 FSR, the format changed and did not reflect the appropriate amounts needed to show the match. The letter further noted that the program has and will be using state funded employee salaries as the required match for 2003 and in future years. Additionally, detailed backup information will be maintained in the SDWB offices for documentation purposes.

All three audit items have been addressed and resolved.

F. DWSRF NATIONAL STRATEGIC PLAN, LOAN RECIPIENT, PROJECTS & TYPES OF ASSISTANCE

1. U.S. Environmental Protection Agency DWSRF Strategic Plan Goals and Objectives.

Strategic Plan Goal 2: Clean and Safe Water

Strategic Plan Objective 2.1: Protect Human Health - Protect human health by reducing exposure to contaminants in drinking water (including protecting source waters), in fish and shellfish, and in recreational waters.

Strategic Plan Sub-objective 2.1.1: Water Safe to Drink - By 2008, 95% of the population served by community water systems will receive drinking water that meets all applicable health-based drinking water standards through effective treatment and source water protection.

Hawaii's Contribution and Support of the National EPA DWSRF Strategic Plan:

The Hawaii DWSRF program supports the above mentioned National USEPA DWSRF Strategic Plan Goal 2 (Clean and Safe Water), Objective 2.1 (Protect Human Health), and Sub-objective 2.1.1 (Water Safe to Drink). Specifically, Hawaii has established and is managing the revolving loan fund to make low cost loans to water systems to finance the cost of infrastructure projects to achieve or maintain compliance with Safe Drinking Water Act requirements. Hawaii DWSRF activities support USEPA Program Reporting Code (PRC) 201B81E.

Every summer, Hawaii and USEPA negotiate Hawaii's Strategic Plan commitments for the SFY starting July 1. Hawaii submitted its SFY 2005 Strategic Plan commitments for the Federal Fiscal Year starting October 1. At that time, Hawaii projected an SFY 2005 Fund Utilization Rate of 60% compared to the projection of 50% in SFY 2004.

All SFY 2005 loans and prior year loans have assisted public water systems meet the federal and state drinking water compliance requirements. Details of Hawaii's DWSRF activities supporting the National USEPA Strategic Plan will be submitted to EPA in August 2005 as part of the Drinking Water National Information System data collection

effort.

2. Closed Loans: As of June 30, 2005 and since the inception of the program, Hawaii's DWSRF program has executed 22 loans for \$58,369,000. In SFY 2005, Hawaii's DWSRF program executed 3 final loans for \$4,304,115.

FINANCIAL SECTION

The following is a summary of the financial activities of the program for the fiscal year ended June 30, 2005. The Department of Health (DOH) considers the DWTRLF to be a special revolving fund. The fund was established to receive proceeds from specific revenue sources such as Federal Capitalization Grants, State Capital Improvement Project (CIP) Appropriations for State Match, loan repayments, and interest earnings from investments and fees.

A. INTERNAL CONTROLS

The DWTRLF program is responsible for establishing and maintaining a system of internal accounting controls to ensure compliance with applicable laws and regulations related to federal and state financial assistance programs. The objective of an internal control system is to provide the program with reasonable, but not absolute, assurances that assets are safeguarded against loss from unauthorized use or disposition. It also ensures that transactions are executed and recorded with proper authorization to permit preparation of financial statements in accordance with generally accepted accounting principles.

Based on annual Performance Evaluation Reviews by EPA and annual financial audits by independent auditors, we believe that the DWTRLF program's internal controls adequately safeguard assets and provide reasonable assurances of proper recording of financial transactions.

B. ACCOMPLISHMENTS OF THE PROGRAM

1. Sources of Funds:

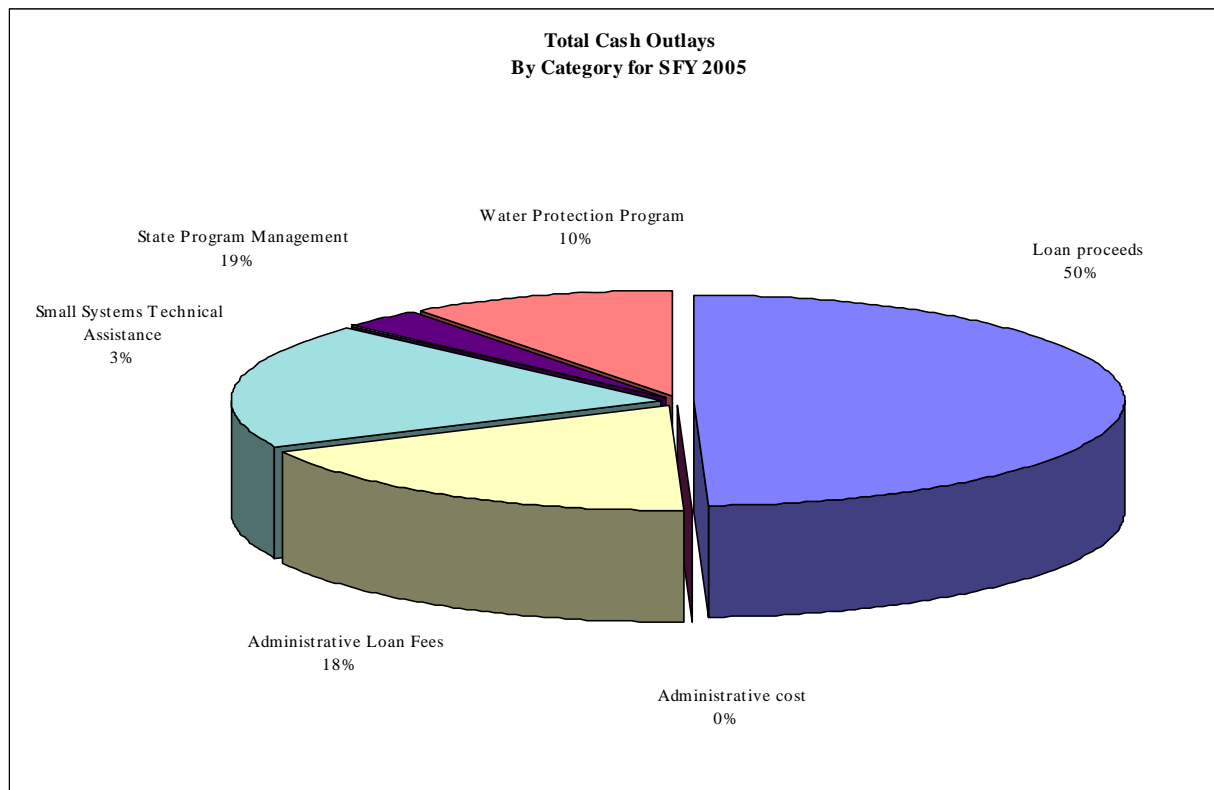
Since the program's inception, the DOH has received a total of \$50,742,500¹ in federal capitalization grants. Of this amount, \$12,444,651 was set aside to support other drinking water program initiatives and administration of the loan program with the remaining \$38,297,849 earmarked for DWTRLF loan funds.

To date, the DOH has committed \$45,147,927.32 of federal capitalization grant funds and \$12,655,680.29 of state match funds to the water boards of the four major counties of Hawaii. These funds have benefitted communities of all sizes in the State of Hawaii.

Graph 3 below shows the significance of loan proceeds in relation to all costs associated with the DWTRLF's operations.

¹ The FFY 2003 Appropriation of \$8,004,100 was made available to the DWTRLF in September 2005. Also in October 2005, the Department of Health received the FFY 2004 Appropriation Award of \$8,303,100.

Graph 3.



2. State Match:

Pursuant to Appropriations Act 41/04, the 2004 Hawaii State Legislature appropriated \$1,611,000 in general obligation bond funds for the required state match for the FFY 2004 EPA SRF Capitalization Grant. The state match was transferred to the DWTRLF's account in June 2005.

Hawaii State law prohibits the program from using State CIP funds (match funds) for administrative purposes. In order to comply with EPA's disbursement requirement, the program obligates all the state match funds to loan projects. Thus, the program maintains a greater percentage of state match funds vs. cash draw for each active capitalization grant.

3. Executed Loan Agreements/Binding Commitments:

As of June 30, 2005, the DOH committed \$45,147,927.32 of federal capitalization grant funds and \$12,655,680.29 of state match funds to DWTRLF projects. The State of Hawaii defines an interim loan agreement as the legal obligation document binding the term of DWTRLF assistance.

4. Automated Standard Application for Payments (ASAP):

The program drew \$1,283,843.40 of its capitalization grant funds from the ASAP system during SFY 2005. Of this amount, \$635,771.84 was used for DWTRLF loans and \$648,071.56 was used to fund the DWTRLF set-aside operations.

5. Loan Repayments and Investment Interest:

Under the DWTRLF, the program established several accounts or activity codes to track the program's revenue sources. These funds are legally restricted for use to fund expenditures for drinking water infrastructure projects, eligible costs for program set-aside activities under the Safe Drinking Water Act, and administrative costs relating to the operation and maintenance of the DWTRLF Program.

Loan repayments and investment interest are deposited into the following DWTRLF accounts:

Account code 422 - Principal from repayments;
Account code 423 - Interest from repayments;
Account code 424 - investment interest.

In SFY 2005, DOH received \$730,131.31 from principal from repayments, \$181,382.23 from interest from repayments, and \$335,727.79 from investment interest.

For SFY 2006, the program is projected to receive principal and interest repayments and investment interest of \$772,892.56, \$177,020.28, and \$284,347.41, respectively.

6. MBE / WBE:

The recipients of the federal funds are required to procure Minority Business Enterprises (MBE) and Women's Business Enterprises (WBE) for all State Revolving Fund (SRF) projects. The DOH has agreed to the following fair share goals of MBE and WBE:

	<u>MBE</u>	<u>WBE</u>
Construction	50%	4%
Services	29%	7%
Supplies	21%	2%
Equipment	27%	2%

In SFY 2005, DWTRLF loan recipients did not award any drinking water construction contracts to MBE's or WBE's. Therefore, there were no federal loan funds awarded to minority owned business enterprises and women owned business enterprises. The program did, however, procure services, supplies, and equipment contracts with set-aside funds as follows:

	<u>Total Amount</u>	Amount Awarded to MBE	Percentage of MBE Utilization	Amount Awarded to WBE	Percentage of WBE Utilization
Service	\$619,940.56	\$183,325.70	30%	\$0.00	0%

As part of the programs compliance with federal SRF requirements, form 5700-52A (U.S. Environmental Protection Agency MBE/WBE Utilization Under Federal Grants, Cooperative Agreements, and Interagency Agreements) is submitted directly to EPA on a quarterly basis. All forms are signed by the program's authorized representative and are on file with EPA.

C. PROGRAM ACTIVITIES

Highlights of the program's activities are as follows:

1. The program completed a priority list, developed the FFY 2005 Intended Use Plan, and prepared the capitalization grant application.
2. The program serviced 22 interim and final DWTRLF loans which totaled \$58,369,000.61.
3. The program reviewed planning documents (including the preliminary engineering reports, plans and specifications, environmental assessment documents, and federal requirement documents) for eleven projects.
4. The program executed four interim and three final loan agreements for \$15,429,595 and \$4,304,115, respectively.
5. The program conducted eight construction inspections of ongoing DWTRLF projects under construction.
6. To administer the DWTRLF program and its related drinking water programs, the program paid \$1,904,063.28. This consisted of \$941,992.53 in loan disbursements and \$342,130.19 in administrative loan fee costs. The expenditures for the other drinking water programs were: \$370,543.11 for State Program Management (10%), \$65,000.00 for the Small Systems Technical Assistance Program (2%), and \$184,704.99 for the Water Protection Program (15%).

Administrative Loan Fees and Administrative Costs (4%)

The State does not contribute any money towards administering the DWTRLF Program and its drinking water-related programs. Furthermore, Federal law requires that the DWTRLF

program be operated in perpetuity. Thus, to pay for employee salaries and benefits and to comply with the Federal law, the DOH implemented a loan fee program on May 17, 2000. For SFY 2005, the DWTRLF program collected \$331,703.60 in administration loan fee - program income and \$104,350.41 in administration loan fee - non-program income. In addition, the program can use up to four percent (4%) of each year's federal capitalization grant to pay for administrative costs.

Small Systems Technical Assistance (2%)

The SDWB issued a contract to provide training to small water systems using the 2% monies starting in October 2004 and continuing for five years. This contract can be referred to as a "circuit rider contract." Under the terms of this contract, the contractor (Rural Community Assistance Corporation) is required to contact small, privately owned public water systems over the course of the contract period and provide hands on training in technical, financial, and managerial areas to systems in need of assistance. The contract will use approximately \$650,000 from this fund. The circuit rider program will also implement a "hot line" via either telephone or e-mail to provide operators with an avenue to obtain help when needed. To date, the circuit rider is visiting water systems on all islands and is beginning to have a positive impact with the water systems. Water system managers and operators are beginning to ask for assistance on "how to" operate and manage their water systems. This is a significant change from earlier response of water systems to other efforts to provide technical assistance.

In addition, work has begun on a contract to assist small water systems apply for rate increases to the State of Hawaii, Public Utilities Commission (PUC). The present process is extremely cumbersome and is estimated to cost each utility approximately \$100,000. This money is required "up front" and many small water systems do not have this kind of money available to them to spend on this activity, and therefore do not apply for rate increases. This jeopardizes their ability to maintain good financial capacity. The PUC's response to this high cost complaint is that the utility can build this cost into the rate increase, which of course will not help them pay for the cost of applying for the currently needed rate increase. The Hawaii Drinking Water Program believes that the ability of small water systems to maintain adequate water rates will continue to be a key factor in the systems' ability to maintain adequate capacity.

State Program Management (10%)

The Safe Drinking Water Act Amendments of 1996 provided that up to ten percent of the DWTRLF Capitalization Grant could be used for State Program Management. These funds were generally delegated to support four major activities.

1. Source Water Protection Program

The Source Water Assessment and Protection Program completed 25 additional SWAP Assessment Reports for new drinking water sources. The program is also working with

EPA to identify/locate Large Capacity Cesspools in delineated source water assessment areas.

As the Safe Drinking Water Branch (SDWB) moves from source water assessments to source water protection, efforts have been focused on educating water systems, the public, and other applicable organizations on development of protection strategies and plans. This year, the SDWB (with the support of EPA) conducted two “Best Management Practices & Other Measures for Protection Drinking water Supplies” workshops on Maui and Oahu; conducted meetings on the major islands to inform water systems, government agencies, and the public about the results of the assessments and plans for source water protection; and participated in the American Water Works Association’s Source Water Protection Symposium by presenting a poster on “Source Water Protection in Hawaii - A Historical Perspective of Water Resource Protection - Ancient Hawaii to the Present.”

2. Public Water System Supervision Program

The Hawaii Public Water System Supervision Program made substantial progress in SFY 2005 in the areas of rule development and primacy package submittal, as well as improving our sanitary survey compliance. The program was able to prepare four additional rules for public hearing during SFY 2005. The LT1 Enhanced Surface Water Treatment Rule, the Filter Backwash Recycling Rule, the Revised Public Notification Rule and the Arsenic and Clarifications to Monitoring and New Source Monitoring Rules are expected to be approved by the Governor for public hearing in early SFY 2006.

The contract for the sanitary survey of the Honolulu/Windward/Pearl Harbor water system was completed in April of 2005. In addition, the SDWB completed 23 other sanitary surveys, for a total of 24 surveys for SFY 2005. These surveys contribute significantly to strengthening the protection of drinking water quality.

The program expended significant resources to deal with complaints from the upcountry Maui area during SFY 2005. These complaints originally claimed that corrosion control additives used to prevent lead from leaching into drinking water from pipes and piping material were causing skin irritation. However, with the change to pH/alkalinity adjustment using food grade lime or soda ash, people’s beliefs started to change in SFY 2005. Many, among the small but vocal group of complainants, currently suspect that the microbes in the distribution system is continuing to cause skin irritation and a wide variety of illnesses throughout Upcountry Maui.

Despite significant improvements to the overall water quality, some residents continue to complain of rashes, infections, general poor health, and even cancers, which they still attribute to their drinking water. To date, there has been no direct evidence linking the varied medical conditions with the quality of the drinking water in Upcountry Maui.

In response to these very vocal complaints, agencies on the county, state and federal

levels have taken various actions. All levels have attended several community meetings on the subject, attempting to address concerns of the community.

The County of Maui, Department of Water Supply has changed both corrosion control additives and disinfection chemicals and levels as well as contracted, using federal funds, for a study of the entire disinfection, corrosion control, lead contamination and other water quality issues.

The State Department of Health has been the primary recipient of the complaints. As a result, it has conducted special sampling for pseudomonas, with guidance from the Centers for Disease Control; tested the Upcountry Maui water systems for other indicators of water quality; responded to legislative proposals to set a standard for HPC in drinking water; and continues to track the progress of studies and contributes to the study oversight committee.

At the federal level, a member of our Congressional delegation appropriated a grant (\$497,000) administered through the EPA to try to resolve the reported problems. A second member of Congress has sent an inquiry to the Department concerning the situation. The EPA is now overseeing, through a committee, the expenditure of the grant funds to assure that these funds are directed at resolving the problem. The EPA has also provided technical assistance to this effort in the areas of health effects, regulation and water system operation and maintenance.

The program saw an increase in violations of standards for disinfection by-products and TCP in SFY 2005. A major part of this increase occurred in the Upcountry Maui water systems as they attempted to improve protection against microbial contaminants. The Program continues to work with the one system that has a long-standing Surface Water Treatment Rule violation for failure to adequately treat surface water. The Kaluakoi Water System is expected to meet their compliance commitment by having a treatment system in place by September 15, 2005.

During SFY 2005, emphasis was placed on examining the compliance status of Hawaii's public water systems with the Revised Radionuclides Rule. This rule became effective in December 2003 and requires substantial additional monitoring for radionuclides. Initial monitoring for this rule must be completed by December 31, 2007.

It was determined that 80 of the 112 public water systems required to meet the monitoring requirements of the rule by 2007 have qualified to be grand-fathered based on data taken between June 2000 and December 2003. Another 21 public water systems have initiated the required quarterly initial monitoring requirements and it is expected that all systems in Hawaii will soon be meeting the initial monitoring requirements under this rule. So far, all systems have demonstrated good compliance with the maximum contaminant levels of all regulated radionuclides. Approximately 30 violation letters were sent to the water systems which failed to monitor for the 2000 to 2003 monitoring period.

The program continued to provide certification reviews for laboratories performing safe drinking water analyses. Currently, 12 microbiological laboratories and 30 chemistry laboratories hold certifications for one or more drinking water chemical parameters.

Finally, the SDWB continues to successfully implement the terms of the many drinking water rules for which it either has primary enforcement authority (primacy) or intends to apply for primacy. These include: the Total Coliform Rule, the Surface Water Treatment Rule, the Enhanced Surface Water Treatment Rule, the LT1 Enhanced Surface Water Treatment Rule, the Phase 1 Volatile Organic Chemical Rule, Phase II SOC/IOC Rule, the Phase V SOC/IOC Rule, Lead and Copper Rule (including Minor Revisions, Revised Public Notification Rule, Revised Radionuclides Rule, Consumer Confidence Rule, Filter Backwash Recycling Rule, Disinfectant/Disinfection By-Products Rule, Arsenic and Clarifications Rule, and more).

3. Capacity Development Program

The program's capacity development program efforts for SFY 2005 were concentrated in the Training Contract and the Technical Assistance Contract described in the section on Local Assistance to Public Water Systems and the Circuit Rider contract described in the Small System discussion. Another program effort includes the establishment of a contract with the University of Hawaii's Outreach College to establish an ongoing training program for water system operators. This contract used funding from the Operator Expense Reimbursement Grant to begin the program and calls for the college to continue offering classes for re-certification of operators. Classes under this contract are scheduled to begin in August 2005.

4. Operator Certification Program

The SDWB continues to administer an operator certification program for water treatment plant operators and distribution system operators.

From July 1, 2004 to June 30, 2005, the Board of Certification of Operating Personnel in Public Water Systems met four times. During this period:

- 129 Applications were received for certification review.
- 21 Persons were tested for the WTPO certification (Examinations were held on July 26, 2004 and January 26, 2005).
- 124 Persons were tested for the DSO certification (Examinations were held on October 25, 2004 and April 26, 2005).
- 12 Reciprocal certifications were issued.
- 7 Persons passed the WTPO certification examination.
- 39 Persons passed the DSO certification examination.
- 192 WTPO certifications were active as of June 30, 2004.
- 359 DSO certifications were active as of June 30, 2004.
- 21 Public water systems required to have level 1 certified water treatment plant

- operators by the level of the plant.
- 8 Public water systems required to have level 2 certified water treatment plant operators by the level of the plant.
- 5 Public water systems required to have level 4 certified water treatment plant operators by the level 4 certified water treatment plant operators by the level of the plant.
- 127 Public water systems with at least one distribution system operator certified at the level of the distribution system of the water system.

Water Protection Program (15%)

The SDWB also began making revisions to Hawaii's Wellhead Protection Program Plan that will allow the SDWB to utilize the 15% DWSRF funding to create Local and Wellhead Protection Workgroups and implement protection projects and began the framework for creating State, Local, and Private Water System workgroup to develop and implement source water/wellhead protection activities.

D. CREDIT RISKS OF THE DWTRLF LOANS

The SRF program requires that every applicant pledge a dedicated source of revenue to repay the loan. Dedicated sources of revenue include a pledge of the county's full faith credit and/or a pledge of general obligation bonds or a dedicated revenue source.

The program lacks the necessary resources to conduct a comprehensive drinking water service and operational analysis. In general, the more highly rated water and sewer enterprises share an important fundamental characteristic with other highly rated debt: a strong underlying economic basis and service area. Nearly all highly rated enterprises are located in areas characterized by solid, steady growth in a strong and diverse service area. Although there is no correlation between a general obligation bond rating and a water and sewer enterprise rating, the common themes of the economic fundamentals should result in similar ratings. Indicators such as customer growth, balance of customers between residential, commercial and industrial, new connections, income trends, and the outlook for economic performance and the ability to withstand economic stresses are important considerations for an enterprise.

Table 1 contains specific information regarding the credit worthiness of our four DWTRLF recipients. The table shows the credit rating categories for these recipients. The General Obligation (G.O.) Bond credit agencies, Moody's and Fitch, gave every Hawaii county's board of water or board of water supply an "A" or "A-" rating. In summary, the DOH feels that the credit pool of DWTRLF's loan portfolio has a high degree of solvency.

Table 1

<u>Recipients</u>	<u>Committed Amount</u>	<u>Moody's/ Fitch Bond Rating</u>	<u>Percentage of DWTRLF Loan Portfolio</u>
City and County of Honolulu, Board of Water Supply	\$27,030,792.00	Aaa/AAA	46%
County of Hawaii, Water Board	5,089,196.59	A1/A	9%
County of Maui, Board of Water Supply	14,803,527.00	Aa3/AA-	25%
County of Kauai, Board of Water Supply	<u>11,445,485.02</u>	A1/A	<u>20%</u>
Totals	\$58,369,000.61		100%

E. OTHER INFORMATION

This report was prepared in accordance with the Generally Accepted Accounting Principles (GAAP) and Reporting Requirements requested by EPA.

Independent Audit: The accounting firm, PricewaterhouseCoopers LLP, was selected by the DOH to perform the financial audit of the DWTRLF Program for SFY 2005. Although the activities and financial statements for fiscal year 2005 are unaudited as of the date of this report, Grant Thornton LLP did perform an annual financial audit of the DWTRLF Program for SFY 2004.

The auditor's report for the SFY 2004 DWTRLF financial statement was published on October 15, 2004. Page 22 of the audit report reads, *"In our opinion, the State of Hawaii Drinking Water Treatment Revolving Loan Fund complied, in all material respects, with the requirements governing types of service and types of costs allowed or unallowed; matching; level of effort or earmarking requirements; special reporting requirements; special tests or provisions, and claims for advances and reimbursements that are applicable to its major Federal financial assistance program for the year ended June 30, 2004."*

The auditor's report for SFY 2005 will be published sometime in November 2005.

Program information: For any further information regarding this report, please contact the Wastewater Branch at (808) 586-4294 or Safe Drinking Water Branch at (808) 586-4258.

ATTACHMENT 1

DRINKING WATER TREATMENT REVOLVING LOAN FUND PROJECTS RECEIVING SRF ASSISTANCE

DRINKING WATER TREATMENT REVOLVING LOAN FUND PROJECTS RECEIVING SRF ASSISTANCE

<u>No.</u>	<u>Final Agreement Date</u>	<u>Project Description (Project Name - Based on the Final Loan Agreement)</u>	<u>Rate</u>	<u>Loan Amount</u>
1	11/15/1999	213-0001 Kamole Water Treatment Plant	1.55%	7,840,087.00
2	7/15/2001	130-0001 Waimea Treatment Plant Upgrades-Phase II [Interim 11/15/00]	1.37%	739,210.00
3	7/15/2001	410-0001 Damage Repairs to Kokolau Tunnel [Interim 11/15/00]	1.37%	1,663,201.02
4	10/15/2001	101-0001 Saddle Road Well "A" [Interim 11/15/00]	1.37%	1,610,048.59
5	4/15/2002	133-0001 Kukuihaele Well "A" (Replace Waiulili Spring) [Interim 7/15/01]	1.01%	365,285.00
6	4/15/2002	139-0001 Makapala Well (Replace Murphy Tunnel) [Interim 7/15/01]	1.01%	246,355.00
7	4/15/2002	109-0001 Pahala Well "B" (Replace Alii Tunnel) [Interim 7/15/01]	1.01%	539,060.00
8	4/15/2002	107-0001 Kaieie Mauka (Replace Kaieie & Papaikou Springs) [Interim 7/15/01]	1.01%	421,129.00
9	4/15/2002	406-0001 Kekaha Well (Kapilimao Well) [Interim 7/15/01]	1.01%	1,097,536.00
10	7/15/2003	404-0001 Rehabilitation of 27" Steel Pipe, Hanapepe-Elleele Water System [Interim 5/15/02]	0.99%	691,134.00
11	7/15/2003	404-0002 Replace Pipeline at Hanapepe River Crossing and Control of Slope Failure at Hanapepe Well #3 [Interim 5/15/02]	0.99%	1,345,040.00
12	3/15/2004	413-0002 Wailua Homesteads Well No. 3 [Interim 7/15/03]	0.54%	418,967.00
13	1/15/2005	410-0005 Rehabilitate Lihue Steel Tanks 1 & 2 [Interim 7/15/03]	0.46%	1,243,017.00
14	1/15/2005	413-0005 Ornellas 0.2 MG Tank Refurbish [Interim 7/15/03]	0.58%	809,398.00
15	12/15/2004	331-0002 Waimanalo Well III [Interim 3/15/04]	0.10%	2,251,700.00
TOTAL FINAL PROJECTS				21,281,167.61
Interim Binding Commitments				
<u>Interim Agreement Date</u>	<u>Project Description (Project Name - Based on the Interim Loan Agreement)</u>		<u>Rate</u>	<u>Loan Amount</u>
12/15/2003	105-0001	Honomu Well "A" (Replace Akaka Falls Spring)	0.41%	1,168,109.00
3/15/2004	335-0002	Kunia Wells II-Nitrate Treatment Facility	0.10%	6,029,374.00
3/15/2004	335-0003	Ewa Shaft Granular Activated Carbon (GAC) Treatment Facility	0.10%	14,460,755.00
1/15/2005	408-0002	Poipu Road 16 inch Main Replacement	0.16%	1,742,754.00
1/15/2005	413-0006	16 inch Waterline Replacement along Kuhio Highway	0.16%	2,434,438.00
1/15/2005	213-0003	Kamole Weir Water Treatment Facility Clear Well Replacement	0.15%	6,963,440.00
4/15/2005	333-0001	California Avenue Water System Improvements, Parts II and III	0.31%	4,288,963.00
TOTAL INTERIM PROJECTS				37,087,833.00
TOTAL FINAL & INTERIM PROJECTS				58,369,000.61

DRINKING WATER TREATMENT REVOLVING LOAN FUND PROJECTS RECEIVING SRF ASSISTANCE

Planned (Future) Interim Binding Commitments

<u>Project Description ("New" Project Names - Based on Priority List)</u>	<u>Proposed Loan Amount</u>
107-0001 Kaieie Mauka (Replace Kaieie & Papaikou Springs) (Supplemental to the Final)	1,364,537.00
139-0001 Makapala Well (Replace Murphy Tunnel) (Supplemental to the Final)	1,195,946.00
335-0004 Pailani Street Water System Improvements	2,727,587.00
106-0001 Kulaimano Well "B" (Replace Maukaloa Spring)	701,366.00
105-0001 Honomu Well "A" (Replace Akaka Falls Spring) (Adjustment only)	(875,342.00)
133-0001 Kukuihaele Well "A" (Replace Waiulili Spring) (Adjustment-Loan Deobl)	<u>(31,045.00)</u>
TOTAL PLANNED (FUTURE) COMMITMENTS	5,083,049.00
TOTAL FINAL, INTERIM, & PLANNED PROJECTS	<u>63,452,049.61</u>

ATTACHMENT 2

STATEMENT OF NET ASSETS

State of Hawaii
Drinking Water Treatment Revolving Loan Fund

STATEMENT OF NET ASSETS

	<u>June 30, 2005</u>	<u>June 30, 2004</u>
ASSETS		
Current Assets		
Cash and cash equivalents in State Treasury (note C)	\$ 14,727,421.71	\$ 12,108,106.25
Due from other fund (note G)	275,000.00	220,000.00
Accrued Interest (note D)	40,350.23	40,388.05
Accrued Interest from Investment	33,114.56	4,628.20
Accrued Loan Fees, program (note D)	87,860.22	86,681.92
Accrued Loan Fees, non-program (note D)	17,915.41	18,102.91
Due from federal government	1,351,142.13	1,209,947.00
Current maturities of loans receivable (note D)	<u>772,892.56</u>	<u>730,131.31</u>
Total Current Assets	17,305,696.82	14,417,985.64
Loans Receivable, net of current maturities (note D)	13,038,016.61	12,868,916.64
Capital Assets		
Office Equipment (notes B and F)	661,958.81	649,194.41
Less: Accumulated Depreciation (notes B and F)	<u>(448,702.95)</u>	<u>(366,764.35)</u>
Total Office Equipment	213,255.86	282,430.06
Transportation Equipment (notes B and F)	47,233.06	47,233.06
Less: Accumulated Depreciation (notes B and F)	<u>(47,233.06)</u>	<u>(47,233.06)</u>
Total Transportation Equipment	<u>-</u>	<u>-</u>
Total Capital Assets	<u>213,255.86</u>	<u>282,430.06</u>
TOTAL ASSETS	<u><u>\$ 30,556,969.29</u></u>	<u><u>\$ 27,569,332.34</u></u>
LIABILITIES & NET ASSETS		
Current Liabilities		
Payroll Payable	\$ 13,508.66	\$ 12,823.08
Accounts Payable	<u>51,271.73</u>	<u>-</u>
Total Current Liabilities	64,780.39	12,823.08
Net Assets		
Invested in capital assets	213,255.86	282,430.06
Restricted	30,278,933.04	27,274,079.20
Unrestricted	<u>-</u>	<u>-</u>
Total Net Assets	<u>30,492,188.90</u>	<u>27,556,509.26</u>
TOTAL LIABILITIES AND NET ASSETS	<u><u>\$ 30,556,969.29</u></u>	<u><u>\$ 27,569,332.34</u></u>

The accompanying notes are an integral part of this statement.

ATTACHMENT 3

**STATEMENT OF REVENUES, EXPENSES &
CHANGES IN NET ASSETS**

State of Hawaii
Drinking Water Treatment Revolving Loan Fund

STATEMENT OF REVENUES, EXPENSES & CHANGES IN NET ASSETS

	Year Ended	
	June 30, 2005	June 30, 2004
REVENUES		
Interest earnings from Loans (note B)	\$ 181,344.41	\$ 176,833.53
Administration loan fee earnings, program (note B)	332,881.90	315,761.02
Administration loan fee earnings, non-program (note B)	104,162.91	102,085.44
Total Revenues	618,389.22	594,679.99
EXPENSES BY PROGRAM ACTIVITIES		
Administrative Cost - 4% set-aside	(8,649.82)	28,599.71
Admin. Technical Assistance - 4% set-aside	-	(498.83)
State Program Management - 10% set-aside	436,386.81	323,618.10
Source Water Protection - 10% set-aside	-	-
Capacity Development - 10% set-aside	-	-
Operator Certification - 10% set-aside	5,751.86	4,095.00
Small Systems Technical Assistance - 2% set-aside	97,500.00	-
Water Protection Program - 15% set-aside	6,215.58	165,413.09
Wellhead Protection Program - 15% set-aside	138,697.45	29,279.32
Technical or Financial Assistance - 15% set-aside	55,770.00	148,600.00
Admin Loan Fee - Program	33,826.65	238,221.66
Admin Loan Fee - Non Program	317,703.73	42,368.85
Total Expenses	1,083,202.26	979,696.90
OPERATING INCOME	(464,813.04)	(385,016.91)
NON-OPERATING REVENUES		
Federal contribution	1,425,038.53	2,860,112.43
State matching contribution	1,611,000.00	1,611,000.00
Interest earnings from Investment (note B)	364,214.15	267,653.62
Inter-Government Fund Transfer	240.00	120.00
Total Non-operating Revenues	3,400,492.68	4,738,886.05
CHANGE IN NET ASSETS	2,935,679.64	4,353,869.14
Net assets - beginning of year as restated (note H)	27,556,509.26	23,202,640.12
Net assets - end of year	\$ 30,492,188.90	\$ 27,556,509.26

The accompanying notes are an integral part of this statement.

ATTACHMENT 4

STATEMENT OF CASH FLOWS

State of Hawaii
Drinking Water Treatment Revolving Loan Fund

STATEMENT OF CASH FLOWS

Year Ended June 30, 2005

Cash flows from operating activities:	
Interest income from loans	\$ 181,382.23
Admin Loan Fees	436,054.01
Principal repayments on loans	730,131.31
Disbursement of loan proceeds	(941,992.53)
Personnel costs	(318,594.17)
Payments to vendors	<u>(612,344.75)</u>
Net cash flows used in operating activities	(525,363.90)
Cash flows from noncapital financing activities:	<u>2,840,083.40</u>
Net cash flows provided by noncapital financing activities	2,840,083.40
Cash flows from capital and related financing activities:	
Purchase of equipment	<u>(31,131.83)</u>
Net cash flows provided by capital and related financing activities	(31,131.83)
Cash flows from investing activities:	
Interest from investments	<u>335,727.79</u>
Net cash flows provided by investing activities	335,727.79
NET INCREASE IN CASH	2,619,315.46
Cash Balance at July 1, 2004	<u>12,108,106.25</u>
Cash Balance at June 30, 2005	<u><u>\$ 14,727,421.71</u></u>
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	\$ (464,813.04)
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	100,306.03
Changes in assets and liabilities:	
Decrease in interest receivable on loans	37.82
Increase in administrative fee receivable on loans	(990.80)
Increase in accrued salaries and other administrative costs	51,957.31
Increase in loans receivable	<u>(211,861.22)</u>
Net cash provided by operating activities	<u><u>\$ (525,363.90)</u></u>

The accompanying notes are an integral part of this statement.

ATTACHMENT 5

NOTES TO FINANCIAL STATEMENTS

State of Hawaii
Drinking Water Treatment Revolving Loan Fund

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE A - ESTABLISHMENT AND PURPOSE OF THE DWTRLF

The Safe Drinking Water Act Amendments (SDWA) of 1996 (the Act) authorized the Environmental Protection Agency (EPA) to make capitalization grants to the states for the purpose of providing loans and other types of financial assistance to public water supply systems for drinking water infrastructure.

The Act also authorized the states to set aside funding for prevention programs and administration of the Fund, provided that the amount of funding did not exceed thirty-one percent (31%) of the annual capitalization grant as follows:

1. Up to fifteen percent (15%) may be used to provide local assistance and other state programs.
2. Up to four percent (4%) may be used to cover the costs of program administration.
3. Up to ten percent (10%) may be used for Public Water System Supervision (PWSS) program activities and other initiatives of the SDWA.
4. Finally, up to two percent (2%) may be used to support small systems technical assistance activities.

To receive the federal capitalization grants, the 1997 State of Hawaii Legislature established the Drinking Water Treatment Revolving Loan Fund (DWTRLF). The DWTRLF is intended to provide loans in perpetuity to public drinking water systems for construction of drinking water treatment facilities. Such loans may be at or below market interest rates and must be fully amortized within twenty years, with the first repayment of principal and interest occurring no later than one year after the notice to proceed for construction or the final agreement date, whichever is later. The Fund is administered by the Safe Drinking Water Branch, Environmental Management Division of the Department of Health (DOH), State of Hawaii.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE B - ACCOUNTING POLICIES

1. Financial Statement Presentation

The financial statements are intended to present the financial position and results of operations of only that portion of the funds of the DOH, State of Hawaii that is attributable to the transactions of the DWTRLF.

The accompanying financial statements of the DWTRLF have been prepared in conformity with accounting principles generally accepted in the United States of America prescribed by the Governmental Accounting Standards Board (GASB).

In June 1999, the GASB issued Statement 34, Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments. This Statement established new financial reporting requirements for state and local governments and required new information as well as restructuring much of the information that governments presented in the past. GASB also required additional statements in conjunction with Statement 34 (e.g., Statement 36, Recipient Reporting for Certain Shared Nonexchange Revenues, Statement 37, Basic Financial Statements – Management’s Discussion and Analysis – for State and Local Governments: Omnibus, and Statement 38, Certain Financial Statement Note Disclosures). The DOH implemented these standards in fiscal year 2002.

2. Measurement Focus and Basis of Accounting

The accompanying financial statements are reported using the economic resources measurement focus (i.e., recognizing all revenues earned during the year) and the accrual basis of accounting. Revenues are reported when earned and expenses are reported when a liability is incurred, regardless of the timing of the related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Proprietary funds have the option under GASB 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting, to elect to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB conflicts with GASB. The DWTRLF has elected to not apply FASB statements after the applicable date.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE B - ACCOUNTING POLICIES (continued)

2. Measurement Focus and Basis of Accounting (continued)

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from services or goods in connection with a proprietary fund's principal ongoing operations. Revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses. The principal operating revenues of the DWTRLF are interest income and administrative loan fees on loans made to county governments. Federal grants, state matching funds, and interest income from investments are reported as nonoperating income.

Net assets are restricted when constraints placed on them are either externally imposed or imposed by constitutional provisions or enabling legislation. Internally imposed designations of resources are not presented as restricted net assets. When both restricted and unrestricted resources are available for use, generally, it is management's policy to use restricted resources first, then unrestricted resources as they are needed.

3. Capital Assets

Capital assets, which includes equipment, are reported in financial statements. Management capitalizes equipment if the cost is in excess of \$5,000 and the useful life exceeds one year.

Purchased capital assets are valued at cost. Donated assets are recorded at their fair market value at the date of donation.

Depreciation expense is recorded in the financial statements. The straight-line method is utilized over the assets' estimated useful life. Generally, the useful life used for equipment is three to seven years.

4. Administration Costs

The accompanying financial statements do not reflect certain administration costs incurred which are paid for by other sources of funding from the DOH. These costs include the

State of Hawaii
Drinking Water Treatment Revolving Loan Fund

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE B - ACCOUNTING POLICIES (continued)

4. Administration Costs (continued)

DOH's and State's overhead which the DOH does not assess to the SRF. It's not practical to determine the amount of such costs.

5. Fund Accounts

The DWTRLF consists of the State Revolving Fund (SRF) and non-SRF activity. The SRF activity consists exclusively of the state match, federal capitalization grant loans, principal loan repayments, and interest from loans and investments. Non-SRF activity consists of administration loan fees and federal set aside funds.

6. Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE C - CASH AND CASH EQUIVALENTS

All monies of the DWTRLF are deposited into the State Treasury. The State Director of Finance is responsible for the safekeeping of cash in the State Treasury in accordance with State laws. The Director of Finance may invest any monies of the State, which in the Director's judgment are in excess of the amounts necessary for meeting the immediate requirements of the State. Effective August 1, 1999, cash is pooled with funds from other State agencies and departments and deposited into approved financial institutions or participates in the State Treasury Investment Pool System. Cash accounts that participate in the investment pool accrue interest based on the average weighted cash balances of each account.

The State requires that the depository banks pledge, as collateral, government securities held in the name of the State for deposits not covered by federal deposit insurance.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE C - CASH AND CASH EQUIVALENTS (continued)

Investments are categorized to give an indication of the level of risk assumed by the DWTRLF. Category 1 includes investments that are insured or for repurchase agreements, collateralized by underlying securities that are so held. Category 2 includes uninsured and unregistered investments for which the broker-dealer in the DWTRLF's name holds the securities. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker-dealer but not in the DWTRLF's name.

NOTE D - LOANS RECEIVABLE

At June 30, 2005, the DWTRLF had outstanding loan receivables with the following government entities:

Seven accounts with the County of Kauai, Board of Water Supply; due in semi-annual payments, including interest at 0.46% to 1.37% commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion.

\$ 4,829,353.20

One account with the County of Maui, Board of Water Supply; due in semi-annual payments, including interest at 1.55% commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion.

\$ 6,076,201.58

State of Hawaii
Drinking Water Treatment Revolving Loan Fund

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE D - LOANS RECEIVABLE (continued)

Six accounts with the
County of Hawaii, Water Board;
due in semi-annual payments,
including interest at 1.01% to 1.37%
commencing not later than one year
after project completion, notice to
proceed, or loan agreement date. Final
payment is due not later than twenty
years after project completion.

\$ 2,905,354.39

One account with the
City & County of Honolulu, Board
of Water Supply; due in semi-annual
payments, including interest at 0.10%
commencing not later than one year
after project completion, notice to
proceed, or loan agreement date. Final
payment is due not later than twenty
years after project completion.

\$ - 0 -

Total

\$13,810,909.17

State of Hawaii
Drinking Water Treatment Revolving Loan Fund

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE D - LOANS RECEIVABLE (continued)

Loans mature at various dates through 2025. The scheduled principal payments on loans maturing in subsequent years are as follows:

SFY2006	\$ 772,892.56
SFY2007	\$ 796,369.56
SFY2008	\$ 806,785.59
SFY2009	\$ 817,917.79
SFY2010	\$ 828,644.35
Thereafter	<u>\$ 9,788,299.32</u>
	\$13,810,909.17

As of June 30, 2005, accrued interest receivable, accrued administration loan fee receivable as program income, and accrued administration loan fee receivable as non-program income on loans totaled \$40,350.23, 87,860.22, and \$17,915.41, respectively.

The program believes that all loans will be repaid according to the loan terms. Accordingly, no provision for uncollectible amounts has been recorded.

As of June 30, 2005, the DWTRLF has committed to make additional loans to the following government entities:

County of Kauai, Board of Water Supply	\$ 4,177,192.00
County of Hawaii, Water Board	1,168,109.00
County of Maui, Board of Water Supply	6,963,440.00
City and County of Honolulu, Board of Water Supply	<u>24,779,092.00</u>
Total	\$37,087,833.00

State of Hawaii
Drinking Water Treatment Revolving Loan Fund

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE E - FEDERAL FUNDING AND STATE MATCH

The DWTRLF is capitalized by grants from EPA authorized by Title VI of the Act with matching funds from the State. As of June 30, 2005, EPA has awarded \$50,746,600.00 to the State, of which \$15,975,766.24 has been drawn for loans and set asides. The State has also legislated matching funds of \$13,409,940.00, of which \$12,655,680.29 has been committed.

The following summarizes the capitalization grants awarded, amounts drawn on each grant, and the balances available for future activity as of June 30, 2005:

<u>Budget Period</u>	<u>FFY</u>	<u>Amount</u>	<u>Total Cash Draws</u>	<u>EPA Draws (Deducted prior to issuance of cap grant)</u>	<u>Funds Available</u>
12/05/97 - 09/30/05	97	\$12,558,800.00	\$11,459,449.61	\$ -	\$ 1,099,350.39
09/24/98 - 09/30/06	98	\$ 7,121,300.00	\$ 3,323,112.93	\$ -	3,798,187.07
02/04/00 - 09/30/07	99	\$ 7,463,800.00	\$ 1,149,355.70	\$ -	6,314,444.30
02/26/01 - 06/30/08	00	\$ 7,757,000.00	\$ 43,848.00	\$ 75,000.00	7,638,152.00
09/01/02 - 09/30/08	01	\$ 7,789,100.00	\$ -	\$ 24,000.00	7,765,100.00
10/01/03 - 06/30/11	02	\$ 8,052,500.00	\$ -	\$ -	8,052,500.00
		<hr/>	<hr/>	<hr/>	<hr/>
		\$50,742,500.00	\$15,975,766.24	\$ 99,000.00	\$34,667,733.76

Note: The FFY 2003 Appropriation of \$8,004,100 was made available to the DWTRLF in September 2005. Also in October 2005, the Department of Health received the FFY 2004 Appropriation Award of \$8,303,100.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE E - FEDERAL FUNDING AND STATE MATCH (continued)

The following is the State Match for each EPA Capitalization Grant for the DWTRLF:

Federal Fiscal Year	Source of State Funds	20% State Match Amount
97	Act 328/27	\$ 2,511,760.00
98	Act 116/98	\$ 1,424,260.00
99	Act 091/99	\$ 1,492,760.00
00	Act 091/99	\$ 28,400.00
	Act 281/00	<u>1,523,000.00</u>
	Total 00 Match	\$ 1,551,400.00
01	Act 328/97	\$ 603,240.00
	Act 259/01	<u>954,580.00</u>
	Total 01 Match	\$ 1,557,820.00
02	Act 177/02	\$1,011,500.00
	Act 259/01	596,420.00
	Act 091/99	1,840.00
	Act 116/98	<u>740.00</u>
	Total 02 Match	\$ 1,610,500.00
03	Act 200/03	\$1,061,320.00
	Act 177/02	<u>539,500.00</u>
	Total 03 Match	\$ 1,600,820.00
04	Act 41/04	\$1,110,940.00
	Act 200/03	<u>549,680.00</u>
	Total 04 Match	<u>\$ 1,660,620.00</u>
	Total 20% State Match	\$13,409,940.00

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE F - EQUIPMENT

The following are the changes in equipment and accumulated depreciation during the year:

	Balance at <u>July 1, 2004</u>	<u>Adjustments*</u>	<u>SFY 2005</u>		Balance at <u>June 30, 2005</u>
			<u>Increases</u>	<u>Decreases</u>	
Equipment	\$588,471.19	\$107,956.28	\$ 31,131.83	\$18,367.43	\$709,191.87
Accumulated Depreciation	329,572.66	84,424.75	100,306.03	18,367.43	495,936.01
	<u>\$258,898.53</u>	<u>\$ 23,531.53</u>	<u>(\$ 69,174.20)</u>	<u>\$ -</u>	<u>\$213,255.86</u>

* Refer to Note H

NOTE G - RELATED PARTY TRANSACTIONS

For the year ended June 30, 2005, the following funds were advanced to the:

Environmental Management, Public Water System Supervision	\$225,000.00
Environmental Management, Environmental Planning Office	<u>50,000.00</u>
	\$275,000.00

State of Hawaii
Drinking Water Treatment Revolving Loan Fund

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE H - RESTATEMENT OF NET ASSETS

During a review of the equipment balances in SFY 2005, errors in SFY 2000 and SFY 2002 were discovered in which equipment with an estimated 7, 5, and 3 year life was erroneously expensed. Other adjustments included changes to the cost of equipment and equipment not expensed under the \$5,000 minimum capitalization policy. The items were corrected by restating the amount of net assets. The effect of these items were to understate net assets as of June 30, 2000 by \$85,659.83, overstate net assets as of June 30, 2001 by \$22,876.86, understate net assets as of June 30, 2002 by \$1,967.87, overstate net assets as of June 30, 2003 by \$19,979.35, and overstate net assets as of June 30, 2004 by \$21,239.96. The effect of these adjustments on total assets has been to increase equipment by \$107,956.28 and increase accumulated depreciation by \$84,424.75, for a net increase of \$23,531.53.